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SIPDIS  
SENSITIVE

DEPT FOR NEA/FO, NEA/ELA  
EEB/IFD/ODF RDEMARCELLUS  
F FOR RNPOLI  
IO FOR A/S BRIMMER  
P FOR DRUSSELL, RRANGASWAMY  
DRL/NESA FOR WHITMAN, BARGHOUT  
STATE PASS TO USAID ESCOTT  
TREASURY FOR SAHERN AND CKNOWLES  
COMMERCE FOR CLOUSTOUNAU/TSAMS/NWIEGLER  
PARIS FOR J MILLER  
USUN FOR WOLFF/GERMAIN/SCHEDLBAUER  
NSC FOR SHAPIRO/MCDERMOTT  
OVP FOR HMUSTAFA

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SUBJECT: CENTRAL BANK GOVERNOR: DESPITE BOOMING ECONOMY,  
LEBANON STILL NEEDS A GOVERNMENT TO MOVE FORWARD ON REFORM

REF: A. BEIRUT 899  
[1](#)B. STATE 81177

SUMMARY  
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[1](#)1. (SBU) The Lebanese economy is booming, with tourists pouring in, hotel occupancy rates high, bank deposits rising, and growth set to beat all forecasts. Nonetheless, Central Bank of Lebanon (CBL) Governor Riad Salameh told the Ambassador August 14 that Prime Minister-designate Saad Hariri needs to form a government that can take on the fundamental economic problems facing the country, including electricity provision, water management, telecom privatization, and environmental protection. Salameh described the efforts the CBL had undertaken to promote growth and development, but said the new government should take advantage of record capital inflows to finance infrastructure development that would increase job creation and promote growth. He believed turning over state assets to Lebanon's resilient private sector would benefit Lebanon, but said political buy-in is crucial, though difficult, because of the political class's dependence on the patronage state-owned institutions provide it. He asked that the United States be patient with Lebanon in its demands for increased budget transparency. End summary.

ECONOMY BOOMING THIS SUMMER...  
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[1](#)2. (SBU) Salameh began his meeting with the Ambassador, PolOff, and EconOff with a dizzying run-down of Lebanon's strong economic indicators as the summer tourist season progresses. He declared that consumer confidence is high, tourists are still arriving, and the Gulf tourists who would normally return home for Ramadan (which begins around August 21) are indicating they will stay for part or all of the fasting month. Hotel occupancy rates are at 70% across Lebanon, and approaching 100% in Beirut, said Salameh.

Because of the strong summer season, Salameh announced he had increased his GDP growth estimate for 2009 to 6%, which would bring GDP to approximately \$32 billion at the end of the year. He saw inflation running at a modest 3%.

¶3. (SBU) Meanwhile, depositors are still placing more capital in Lebanese banks, Salameh affirmed, and he predicted the growth in deposits could reach an astonishing 20% in 2009. High interest rates on Lebanese pounds (LL) have resulted in the conversion of \$13 billion in deposits into LL, according to the Governor, and the banks have \$25 billion in cash deposited at the CBL. He added that the Saudi government still has \$1 billion in reserves at the CBL, and the Kuwaitis \$500 million. With so much liquidity in the banking system, Salameh explained that the CBL had issued circulars to allow banks to offer subsidized interest on student loans, loans for investment schemes to create jobs, as well as for environmentally friendly projects.

...BUT WE STILL NEED A GOVERNMENT  
TO TAKE ON LEBANON'S PROBLEMS  
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¶3. (SBU) Despite the booming economy, Salameh stressed that Lebanon needs a government to take on the important reforms and infrastructure upgrades necessary for economic growth. The huge tourist influx this summer merely highlights the country's needs, in Salameh's view, as electricity, water, and telecommunications infrastructure are stretched to the limit. "We cannot take one more tourist," he said, noting that in addition to power outages and dropped cell phone

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calls, polluted water and environmental degradation can cause health problems that will drive tourists away. Salameh believed PM-designate Saad Hariri was intelligent to take his time in forming a cabinet that can tackle these problems, rather than caving to political pressures that could result in a do-nothing government. He saw Hariri as "aggressively pro-business and pro-reform," but worried that most of the other politicians in Lebanon would not be so anxious to move forward on reform initiatives.

WHILE DEBT IS BAD,  
GOVERNMENT INVESTMENT CAN REAP PROFITS  
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¶4. (SBU) Salameh lamented that since Fouad Siniora took over as Prime Minister in 2005, the GOL has run an average annual budget deficit of \$3 billion. Such spending is unsustainable, he pronounced, and absolute debt levels continue to increase. Nonetheless, he believed the GOL should take advantage of the current abundance of liquidity in the banking system to partner with the private sector and undertake desperately needed infrastructure projects in the electricity and water sectors. With the attractive interest rates available to the private sector under the previously mentioned CBL investment programs, the GOL could reap benefits from investing now, said Salameh, while setting up the economy for further growth. If the GOL does not use the excess liquidity to invest in Lebanon, thought the Governor, then Lebanese banks would simply start lending abroad.

PRIVATIZATION:  
BRINGING THE POLITICIANS ON BOARD  
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¶5. (SBU) Salameh pointed to the resilience of Lebanon's private sector, and said the GOL should not delay in turning its assets over to it. He found it essential that the private sector be brought into electricity generation to break the monopoly of state-owned Electricite du Liban, whose production capacity does not meet Lebanon's needs. He believed the GOL should move forward on privatization of the two mobile telecom licenses by floating the companies on the Beirut Stock Exchange (BSE), which would "make the people

feel involved," and avoid the difficulties of selling to foreign companies in the depressed international market. Likewise, he announced his plan to sell 25% of CBL-owned Middle East Airlines (MEA) on the BSE, hopefully in the first quarter of 2010.

¶6. (SBU) The main obstacle to privatization in Lebanon, opined Salameh, remains the political class, which uses state-owned institutions as patronage instruments. He noted that he had looked into divesting the CBL of its 35% share in Intra, the holding company which runs the Casino du Liban (CdL), but ran into problems because Amal leader Nabih Berri had staffed the Casino with his followers, and did not want to lose the ability to employ his supporters. Other politicians had similar interests in other sectors, noted Salameh. He also noted Druze leader Walid Jumblatt's recent statements against privatization as a sign of the difficulties of building political consensus on offloading state assets. He said he had worked hard to build the political support necessary to float 25% of MEA on the stock exchange, but would have to make further efforts if he wished to sell more of it.

#### BUDGET TRANSPARENCY

¶7. (SBU) The Ambassador discussed Ref B demarche on

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encouraging central budget transparency with Salameh, noting that CBL-owned assets such as MEA and the Casino du Liban do not issue public financial statements. Salameh responded that MEA announces its results at an annual assembly, but that it runs as a private company, not a public entity. He reiterated that the Casino was part of a holding company of which CBL is merely a minority shareholder. In any event, he stressed, it was his intention to remove these entities from the CBL's books as soon as practicable. Meanwhile, on budget transparency generally speaking, Salameh asked that the USG be "patient" with Lebanon, with its intractable political problems which make initiatives like budget reform difficult.

He stressed that U.S. support for Lebanon and its institutions inspires confidence in the GOL among investors and lenders, which is essential to keeping the country afloat.

#### COMMENT

¶8. (SBU) For those of us used to dealing with Lebanon's unruly political leaders, the Governor is always refreshingly on point. Though his complaining about deficit spending seems to contradict his assessment that the GOL should take on more debt for infrastructure spending in the current liquidity glut, it is true medium-term investment that could bring improvements that would ultimately reduce GOL spending.

His plea for "patience" on budget transparency likely reflects a long experience and deep understanding of the political motivations behind the lack of transparency in the current system. Nonetheless, he remains one of our key allies in promoting reforms and is expected to be one of the experts PM-designate Hariri will hopefully rely on for economic advice. End comment.

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